

Office of Chief Counsel
Internal Revenue Service

memorandum

CC: [REDACTED]:NEW:2:POSTF-165620-01
DDHelfgott

date: January 10, 2002

to: [REDACTED]
Case Manager

from: Area Counsel
(Heavy Manufacturing and Transportation:Edison)

subject: [REDACTED]
[REDACTED]

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

This memorandum responds to your request for assistance. The issue is whether the statute of limitations for assessment is open with respect to four partnerships in which the above-captioned taxpayer is a partner. This memorandum should not be cited as precedent.

The facts as you have described them are as follows. The taxpayer is a group filing a consolidated return. The statute of limitations under I.R.C. § 6501 is open for the [REDACTED] taxable year, under Form 872 extensions which do not include any specific reference to partnership items. Various members of the taxpayer's consolidated group are partners in [REDACTED] partnerships. [REDACTED] of the partnerships have less than [REDACTED] members, all of which are C corporations, individuals, or estates.

The remaining partnership has less than [REDACTED] members. However, one of the members was a pass-through entity. This pass-through entity was a "partner" in the sense that it made a contribution to the partnership under the terms of the partnership agreement. However, it was a capital investor only; it did not participate in the profits and losses of the partnership. It sold its interest in the partnership at some point during [REDACTED].

Both the taxpayer and the partnerships file their returns on a calendar year basis. No election was filed by any of these

partnerships to have the unified partnership audit provisions apply for the [REDACTED] year. The partnership returns have not been opened for examination. The partnership statute of limitations under I.R.C. § 6229, if applicable, has expired for each of the four partnerships. You are requesting this advice in order to determine whether to examine certain losses reported by the above-captioned taxpayer as flow through items from these four partnerships.

I.R.C. § 6231(a)(1)(B)(i) provides that, for purposes of Subchapter C (I.R.C. § 6221 et seq., the unified partnership audit provisions), the term "partnership" shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. The amendments to this provision which allowed C corporations to be included within the exception was added by P.L. 105-34, § 1234(a), effective for partnership tax years ending after August 5, 1997. Thus, based on the information provided, for [REDACTED] of the [REDACTED] partnerships, for the [REDACTED] tax year, any flow-through items relating to the partnerships with respect to the taxpayer are subject to the statute of limitations under I.R.C. § 6501, and not I.R.C. § 6229.

However, it appears that the small partnership exception does not apply to the [REDACTED] partnership. Treas. Reg. § 301.6231(a)(1)-1(a)(2) provides that the small partnership exception does not apply to a partnership for a taxable year if any partner in the partnership during that taxable year is a "pass-thru" partner as defined in section 6231(a)(9). Section 6231(a)(9) defines a "pass-thru partner" as a partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership with respect to which proceedings under this subchapter are conducted. Since one or more of the partners in the [REDACTED] partnership is a partnership, the small partnership exception does not apply. Further, because the agreements to extend the statute of limitation under I.R.C. § 6501 did not include any reference to partnership items, they do not operate as an extension of this partnership's items. Rhone-Poulenc Surfactants and Specialties, L.P. v. Commissioner, 114 T.C. 533 (2000), dismissed and remanded on other qds., 249 F.3d 175 (3rd Cir. 2001).

You suggest two possible arguments as to why the pass-thru rules should not apply. First, because the "pass-thru" entity is a "capital investor" only, that is, it is not allocated gain or loss from the partnership, you argue that its tax liability is not affected by partnership items, and it therefore does not

qualify as a 'partner.' However, section 6231(a)(2), which defines the term partner for purposes of Subchapter C, states that a partner is either a partner in the partnership or some other person whose tax liability is determined with reference to partnership items. Thus, under section 6231(a)(2)(A), an individual or entity that is a member of a partnership qualifies regardless of the affect of partnership items on its tax liability. Since the pass-thru entity is a member of the partnership subject to the terms of the partnership agreement, it is a "partner" for purposes of section 6231(a)(2).

Moreover, we believe this partner qualifies under the alternative definition of section 6231(a)(2)(B). Treas. Reg. §301.6231(a)(3)-1 includes in the definition of partnership items certain transactions which a partnership is required to make determinations with respect to, including contributions to the partnership. This partner made contributions to the partnership which figured in the partnership's determination with respect to the pass-thru entity's capital account. Ultimately, these contributions affected its gain or loss upon sale of its partnership interest. Thus its tax liability is determined with reference to a partnership item. Therefore, the pass-thru entity qualifies as a partner even under the second definition of section 6231(a)(2).

Finally, you suggest that the "pass-thru" partner could be eliminated from consideration for the [REDACTED] year because it was not a partner at the end of the following taxable year. However, Treas. Reg. § 301.6231(a)(1)-1(a)(1) provides that the partnership must "at no time during the taxable year" have more than 10 partners. With respect to pass-thru partners, it further provides that the small partnership exception does not apply if a pass-thru partner was a member of the partnership "during that taxable year." § 301.6231(a)(1)-1(a)(2). Since the pass-thru partner was a partner during the taxable year, its subsequent departure from the partnership does not affect the partnership's disqualification for the small partnership exception.

Therefore, we believe that the [REDACTED] partnership was subject to the unified partnership audit provisions, including I.R.C. 6229, and that therefore, the statute of limitations has expired for the taxable years [REDACTED] and [REDACTED].

Please contact Diane Helfgott at (973) 645-2572 if you have any questions.

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